The Real Estate ANALYST

DECEMBER 31
1948

A concise easily digested periodic analysis based upon scientific research in real estate fundamentals and trends. Constantly measuring and reporting the basic economic factors responsible for changes in trends and values....Current Studies.... Surveys....Forecasts

Volume XVII

Number 61

REAL ESTATE ECONOMISTS, APPRAISERS AND COUNSELORS

EASE OF CREDIT AND RESIDENTIAL CONSTRUCTION

THERE are apparently a great many people who believe that credit or the lack thereof has a dominating influence on the building cycle. During the last depression when residential building sank to a very low ebb, the lack of long-term credit was blamed. The easing of long-term credit was (and by many still is) considered the cure for all of the ills afflicting real property. While there may be some foundation for this belief, it has been our opinion for a long time that the presence of easy credit played a supporting role in the cycle rather than a dominating one. Credit must be available before a building boom can start, but its availability will not start a boom unless construction costs and the general price level of improved real estate are comparable.

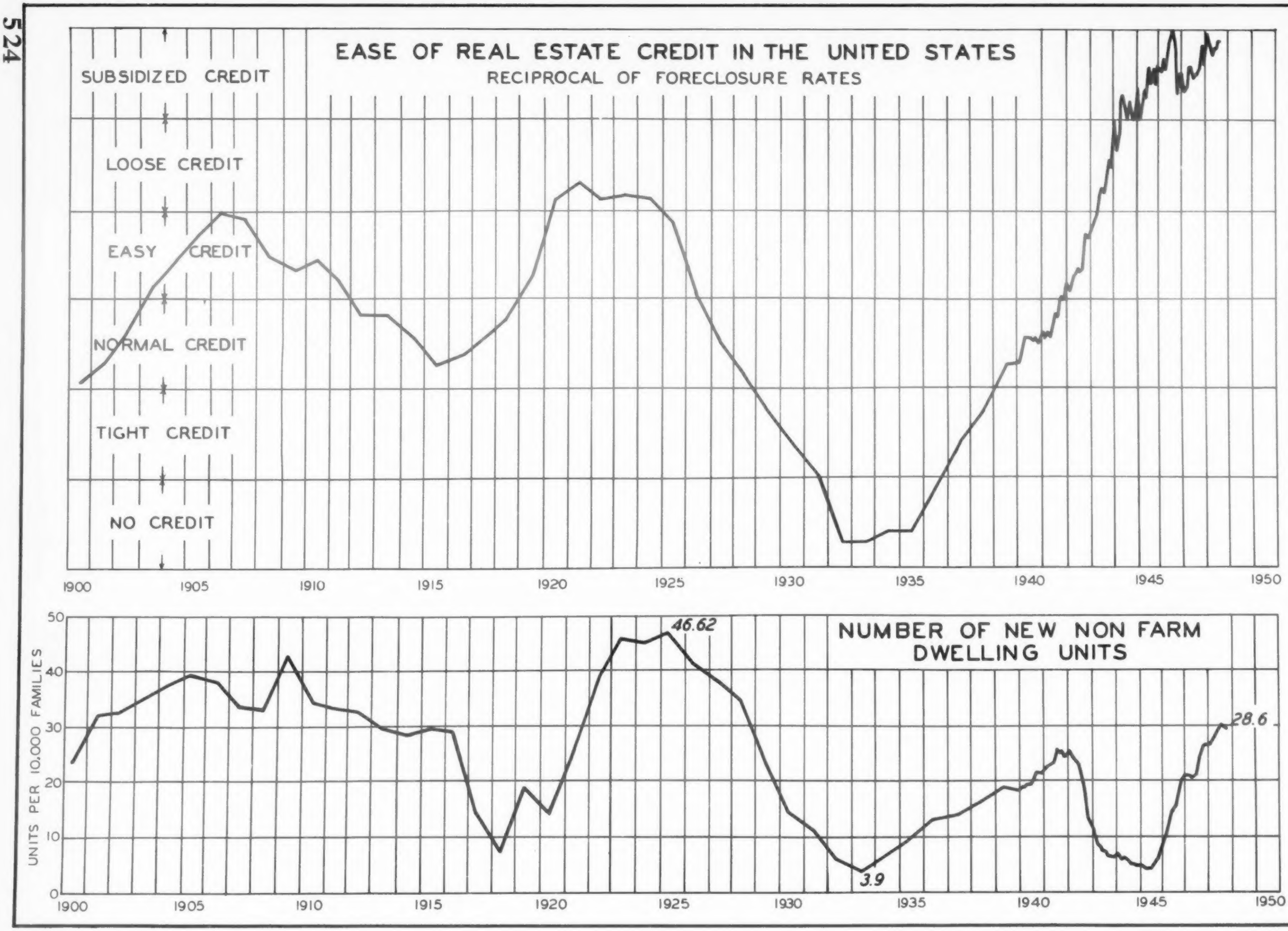
Of far greater importance in the action of the building cycle are those conditions that lead to easing or tightening of credit. Credit for new building disappears when falling rentals, increasing vacancies and rising costs reduce the income from real estate to a point insufficient to pay a return on the investment. Later on, as a housing shortage develops and rents begin to rise, it once more becomes profitable and apparently safe to resume building.

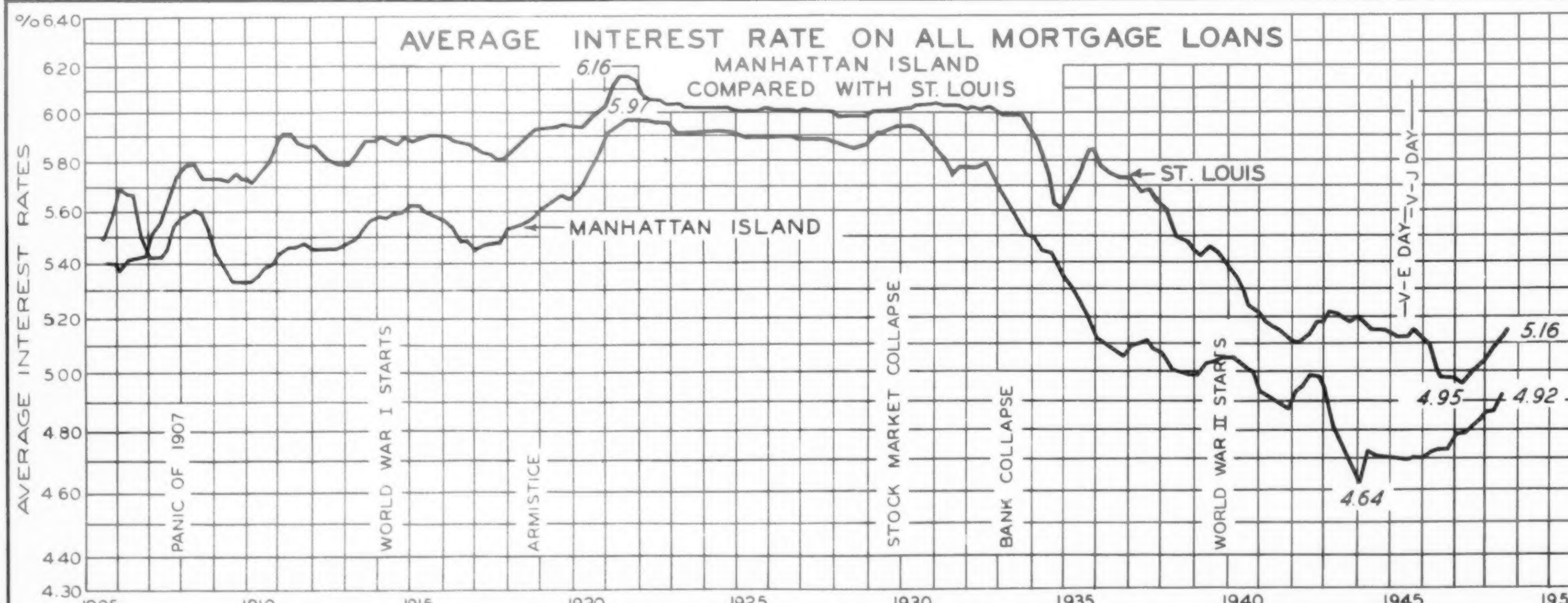
The charts on page 524 show the two factors under discussion - ease of credit and the rate of residential construction.

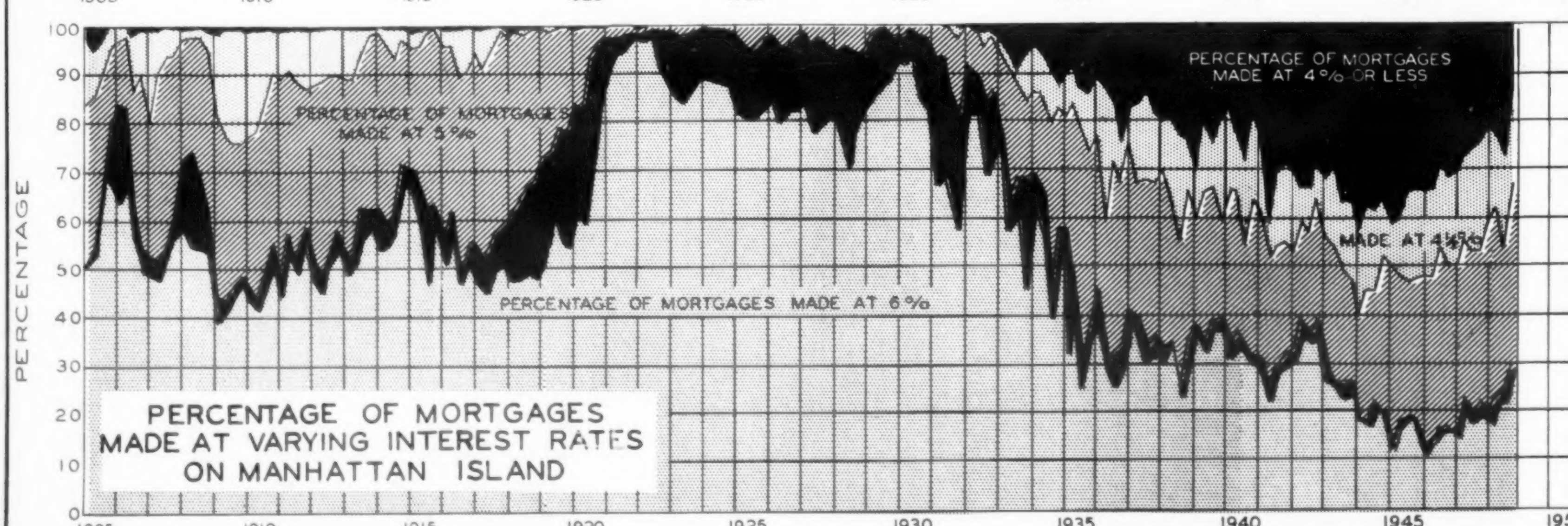
Notice how both lines turn upward following their low points in 1933. The FHA received a good deal of undeserved publicity for "starting" this increase in new residential construction. It is perfectly true that increases in residential construction took place in 1934 and in subsequent years until 1942; however, the general real estate picture, though improving, was still quite shaky in the early and middle thirties. Consequently, credit remained "tight" in spite of the government's guarantee and residential construction did not reach important proportions until 1938 and 1939. By this time the underlying factors that contribute to easier credit had begun to operate. Foreclosures and vacancies had declined sharply while rents had stopped falling and had started a slow rise. Real estate activity, although suffering a relapse in 1938, recovered quite strongly in 1939. These were the factors that sparked the building boom - not the guarantees of the FHA.

Although the FHA has had an important part in easing credit, its guarantees do not diminish the over-all risk. A portion of the risk is shifted from the lenders to the taxpayers and as this takes place more lenders become willing to participate, even at lower interest rates.

(cont. on page 526)


EASE OF REAL ESTATE CREDIT IN THE UNITED STATES
RECIPROCAL OF FORECLOSURE RATES
SUBSIDIZED CREDIT
LOOSE CREDIT
EASY CREDIT
NORMAL CREDIT
TIGHT CREDIT
NO CREDIT
1900
1905
1910
1915
1920
1925
1930
1935
1940
1945
1950
NUMBER OF NEW NON FARM DWELLING UNITS
UNITS PER 10,000 FAMILIES
0
10
20
30
40
50
46.62
3.9
28.6


AVERAGE INTEREST RATE ON ALL MORTGAGE LOANS
MANHATTAN ISLAND
COMPARED WITH ST. LOUIS
AVERAGE INTEREST RATES
6.16
5.97
ST. LOUIS
MANHATTAN ISLAND
5.16
4.95
4.92
4.64
PANIC OF 1907
WORLD WAR I STARTS
ARMISTICE
STOCK MARKET COLLAPSE
BANK COLLAPSE
WORLD WAR II STARTS
V-E DAY
V-J DAY


PERCENTAGE
PERCENTAGE OF MORTGAGES MADE AT 4% OR LESS
PERCENTAGE OF MORTGAGES MADE AT 5%
PERCENTAGE OF MORTGAGES MADE AT 6%
PERCENTAGE OF MORTGAGES
MADE AT VARYING INTEREST RATES
ON MANHATTAN ISLAND

EASE OF CREDIT AND RESIDENTIAL CONSTRUCTION
(cont. from page 523)

The risk, which was comparatively minor from 1934 through 1945, has grown to substantial proportions in the last two or three years. Nevertheless, the FHA continues doing business at the same old stand, guaranteeing enormously inflated loans on virtually the same basis it initiated during the low-cost days of the depression, and shifting the bulk of the risk from the mortgage lenders to the taxpayers - who either do not know what is going on, or are too inarticulate to protest.

Since 1946 construction costs have risen so high that much of the financing that has taken place since then would not have been done without government guarantees. During this period these guarantees have pushed the ease of credit index to a ludicrously lofty position, far out of proportion to the housing industry's ability to absorb this credit. The result of this flood of dollars into the industry has been to increase prices much more rapidly than construction volume.

In the past, whenever the real estate situation has developed to a point where it is capable of bringing forth a construction boom, the credit to finance this boom has been available. As the factors underlying the boom begin to weaken, credit normally tightens. Today, however, the government insists on underwriting loans that by normal standards would be considered unsafe. Although the government's guarantees give some safety to the lender, they fail to alter the unsoundness of many present-day loans, and despite lower interest payments and amortization may well lead to a higher foreclosure rate than would prevail without them.

INTEREST RATES ON MANHATTAN AND IN ST. LOUIS

THE chart on page 525 shows the proportion of loans made at various rates of interest on the Island of Manhattan from 1905 to the present. There are several factors to be considered in reading this chart. For one, the figures are based on the number of loans made at various rates rather than the amount of money lent at these rates. For another, only new loans are included. These two factors will tend to make the average rate appear somewhat higher than it actually is in many portfolios, particularly the portfolios of banks and other more conservative lending agencies. For the most part, individual lenders make smaller loans and at higher rates than do regular mortgage lenders. Therefore, the portfolio of a Manhattan savings bank would show many large loans at low rates, some perhaps as low as 3%, while the same number of loans held by individuals would very probably amount to a much lower total and would undoubtedly carry higher rates.

During this year there has been a marked tendency of new loans for 4% money to grow scarcer and for 6% loans to increase in number. This is a tendency that will probably continue, although at a somewhat slower pace on Manhattan than in other parts of the country. Interest rates on Manhattan are generally lower than the rates prevailing in other parts of the country. There are several reasons for this, among them the fact that so many lending institutions have their headquarters there and competition for loans is keener. Another reason is that a great deal of Manhattan mortgage activity comes from refinancing large income properties and is generally on a sounder basis than loans made on the basis of replacement cost alone.

INVENTORIES, SALES AND NEW ORDERS

AFTER a strong steady rise beginning in 1946, new orders to manufacturers started leveling off about two years ago. While a slight upward trend seems to have developed in recent months, we expect it to return to a lower level during December 1948, or in early 1949. We believe that the peak in orders to manufacturers has been reached and that for the next few months new orders will follow a sideways movement before going into a slow decline. Sales by manufacturers are continuing to rise and will naturally be sustained a short while longer than new orders. Inventories, while large, are not excessive and may be expected to level off cautiously in the following months.

Virtually the same trend has been followed by retail sales and inventories and wholesale sales and inventories.

These charts all represent dollar volume rather than unit sales and for this reason are somewhat of an overstatement of the increase in sales volume inasmuch as a good part of the rise has come from increasing prices.

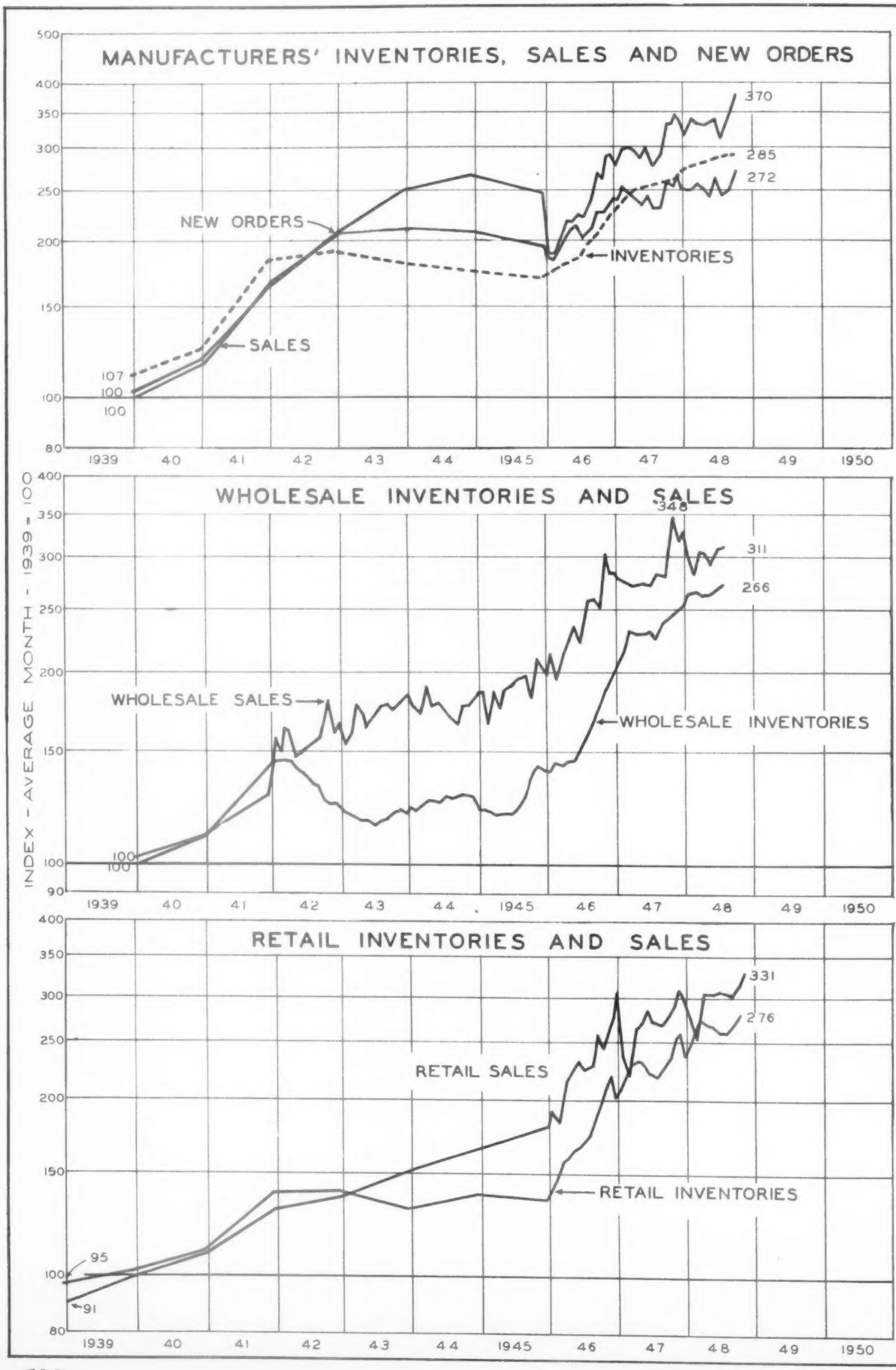
Retail sales are perhaps more in the spotlight than any other factor on these charts. Some retail sales have been slipping recently, particularly in department stores. However, for the first 10 months of 1948 department store sales were up 6% over 1947.

Other major retail sales groups have shown the following changes:

	Change in $ sales first 10 months of 1948 from first 10 months of 1947	Change in $ sales first 10 months of 1947 from first 10 months of 1946
All retail sales	+ 7%	+13%
Auto dealers	+18%	+74%
Household appliances	+ 7%	+50%
Heating & plumbing equipment	- 2%	+35%
Farm equipment	+21%	+31%
Floor coverings & draperies	+ 8%	+20%
Jewelry stores	- 5%	-12%
Tire and battery dealers	- 1%	- 5%
Liquor stores	- 3%	- 5%
Women's ready-to-wear	+ 4%	- 4%

Notice that all groups showing an increase in 1947 over 1946 showed a substantially smaller increase in 1948 over 1947 - and that those groups showing a decrease in 1947 from 1946 showed a smaller decrease this year.

Several large retail groups did not equal 1947 volume, although dollar sales were higher. For example, the food group recorded an increase of 4% in dollar sales, while food prices increased a little over 10%. This would indicate that unit sales were somewhat lower in 1948 than in 1947. We believe that retail sales have just about topped out and that from here on they will be characterized by a downward trend.


MANUFACTURERS' INVENTORIES, SALES AND NEW ORDERS
NEW ORDERS
SALES
INVENTORIES
370
285
272
107
100
100
WHOLESALE INVENTORIES AND SALES
WHOLESALE SALES
WHOLESALE INVENTORIES
348
311
266
RETAIL INVENTORIES AND SALES
RETAIL SALES
RETAIL INVENTORIES
331
276
95
91
INDEX - AVERAGE MONTH - 1939 = 100
1939
40
41
42
43
44
1945
46
47
48
49
1950

THE OVER - EMPHASIS ON RENTS

WE have written many articles condemning rent controls in principle and the administration of the rent control laws in particular. As is the case in practically all instances of government planning, serious inequities develop that far overshadow those inequities the planning is supposed to correct. From the outset our stand on rent controls has been that fundamentally they are undemocratic, are contrary to the Bill of Rights, and that a very dangerous precedent was established by resorting to them, even in time of national emergency. Under the pressure of the wartime housing shortage we saw, and admitted, the need of some rent controls purely as a temporary measure. During the continued shortage following the war we still saw some necessity for them in certain instances. However, we have never been in agreement with their rigidity and have frequently pointed out the need for their modification.

The advocates of rent controls have founded their chief arguments for continuance on the rising cost of living, contending that with other cost of living items rising, most people could not "afford" additional rent charges. This argument has been officially refuted by a survey released in September by the Board of Governors of the Federal Reserve System. This survey disclosed that the average American nonfarm family was paying 12% of its income for rent at the beginning of 1948. The lower income groups - families of less than $2,000 per year - paid 21% of their income for rent, but those families with incomes of $5,000 per year or over paid only 9%. In the middle income group, those families receiving from $2,000 to $5,000 per year, the average rent amounted to 13% of their income.

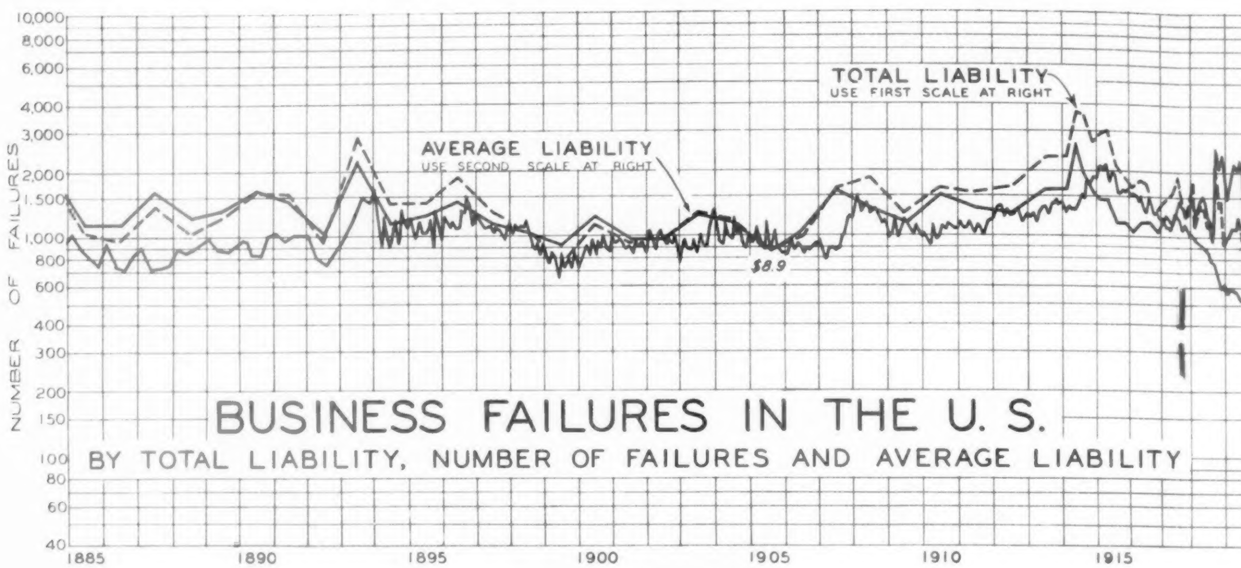
The table below shows the relationship between rent and income in these three groups and what the relationship would be in case a 15% rent rise were allowed:

Income group	% of income spent for rent at beginning of 1948	% of income represented by a 15% rent increase	% of icome spent for rent if 15% rise is allowed
Less than $2,000 per year	21%	3.15%	24.2%
$2,000 to $4,999 per year	13%	1.95%	15.0%
$5,000 and over per year	9%	1.35%	10.4%

Insofar as the low income group is concerned, a 3% per month increase in total expenditure would probably cause some inconvenience to most tenants and actual hardship in the cases of others. In some cases a subsidy might be required to avoid this hardship. We can see no reason, however, why the landlord should be regimented into providing this subsidy. If subsidies are required for tenant families during the most prosperous times the nation has ever experienced, if tenants are unable to pay a just rental in times of full employment and record high incomes, what will be their ability to pay in less prosperous times, or in times of depression?

Do the planners contemplate allowing rent rises after the cost of living has declined on the basis that since a tenant would pay less for food and clothing, he could

(cont. on page 532)



BUSINESS FAILURES CO

THE chart above shows that business failures, total liabilities and average liabilities are all trending upward. Both liability figures are subject to wide fluctuations, but have been moving upward steadily in the last few years, reflecting, no doubt, the continued price rises.

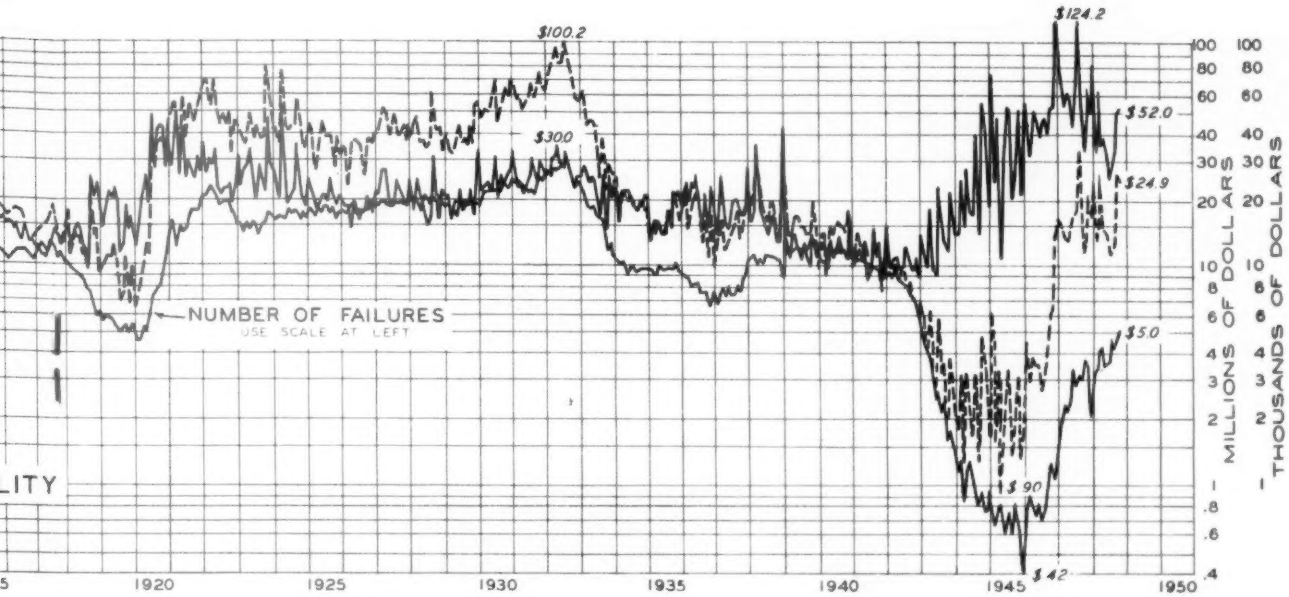
For the first nine months of 1948 business failures totaled 3,800, or 51% above the 2,510 failures for the same period of 1947.

A breakdown of these failures is as follows:

	Jan.-Sept. 1947	Jan.-Sept. 1948	% increase over 1947
Commercial service	218	359	65%
Construction	163	298	83%
Manufacturing & mining	941	1085	15%
Retail trade	855	1572	84%
Wholesale trade	333	486	46%
Total	2510	3800	51%

Perhaps it is significant that the greatest increase has occurred among the construction and retail firms, two fields where high prices have been most active.

Of the recent failures over 80% have occurred among those firms that were started either during the war or since V-J Day. This increase in the number of failures has been expected due to the unusually large number of firms that were started during very high business activity. At the end of the second quarter of 1944 there were approximately 2,880,000 firms doing business in the United States.



RES CONTINUE TO RISE

By the end of the second quarter of 1948 this figure had increased by more than 1,000,000 to a total of 3,881,500 firms.

The rise in the number of failures, therefore, should not necessarily be interpreted as a forerunner of a general decline in business activity. Failures are still lower than at any time prior to World War II, except for a brief period in early 1920.

The rate at which new businesses are being formed has leveled off during the last year or so. Since the second quarter of 1946 when 170,000 new businesses were formed, the number dropped to 110,000 for the second quarter of 1947, and to 84,000 in the second quarter of 1948. From April 1 through June 30, 1948, contract construction firms were the only ones to show a sizable increase in number - 2.3%. The other types of enterprises showed either a very slight increase or, as in the case of manufacturing companies, a slight decrease.

During the last two years the number of discontinued businesses has been increasing slowly. The result of these two trends has been a gradual stabilization of our business population at a level considerably above that of the prewar period. Since the signs now point the way out of the seller's market in most lines, the strain of increasing competition should bring about a continuing decline in the number of business failures.

The chances are that during the next few years we will see a slow decline in our business population.

THE OVER-EMPHASIS ON RENTS
(cont. from page 529)

afford more for rent? We doubt it. If the low-income tenant must be subsidized the government should do the subsidizing, but in no case should the landlord be compelled to.

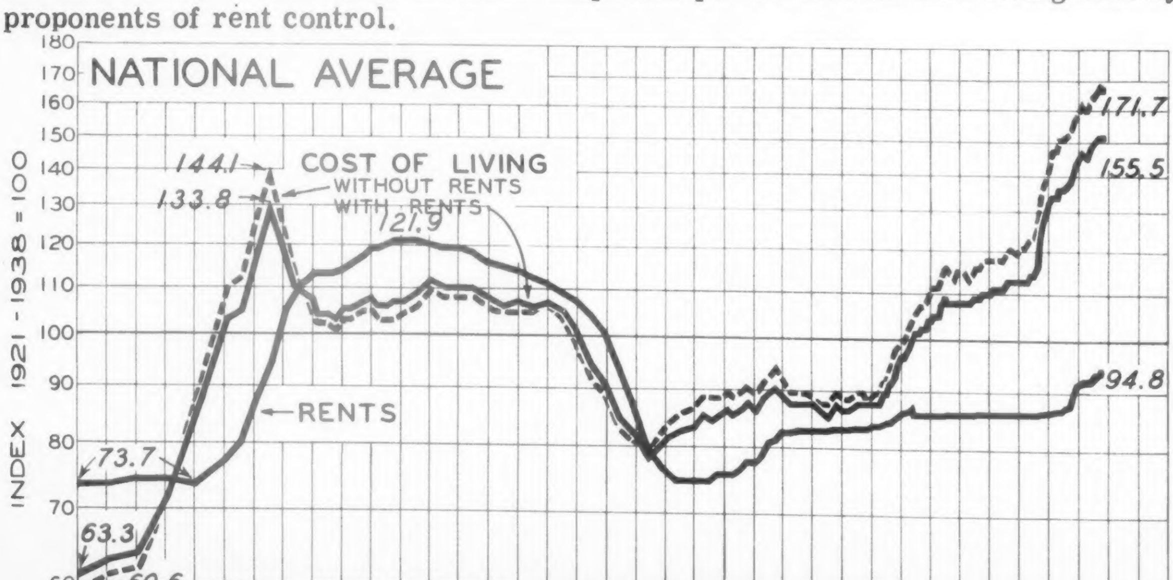
It certainly seems that rents of the middle and upper income groups could be raised by at least 15%. It appears foolish to maintain that these families would suffer hardship by having to increase their total expenditures by 1 or 2% a month.

Assuming that the average family in the middle income group received $290 per month, their rent is (13%) $38. A 15% increase in their rent would raise their monthly expenditure by only $5.70. By this same method of figuring, the higher income groups, with an income of $570 per month, would have their monthly expenditures increased by $7.70. Surely hardship would only result in very unusual cases.

Despite prosperous times and full employment, the government has decided to continue to protect this large group of tenants in the upper and middle income groups (70% of all nonfarm tenants) from an increase of 1 or 2% in their total expenditures. In view of how little the tenant gains and how much the landlord loses, it seems that far too much emphasis has been put on rent control's value to the tenant.

The chart at the bottom of the page shows the course followed by rents, the cost of living (with rents included), and the cost of living without rents from 1913 to the present. The three indexes shown all have the same base period, 1921-1938, an 18-year span containing nine good years and nine bad.

The most significant thing about this chart is the almost identical course followed by the cost of living and the cost of living less rents in the free economy of the last boom. This shows the over-emphasis placed on rent as a living cost by proponents of rent control.



RENTS, COST OF LIVING AND COST OF LIVING LESS RENTS

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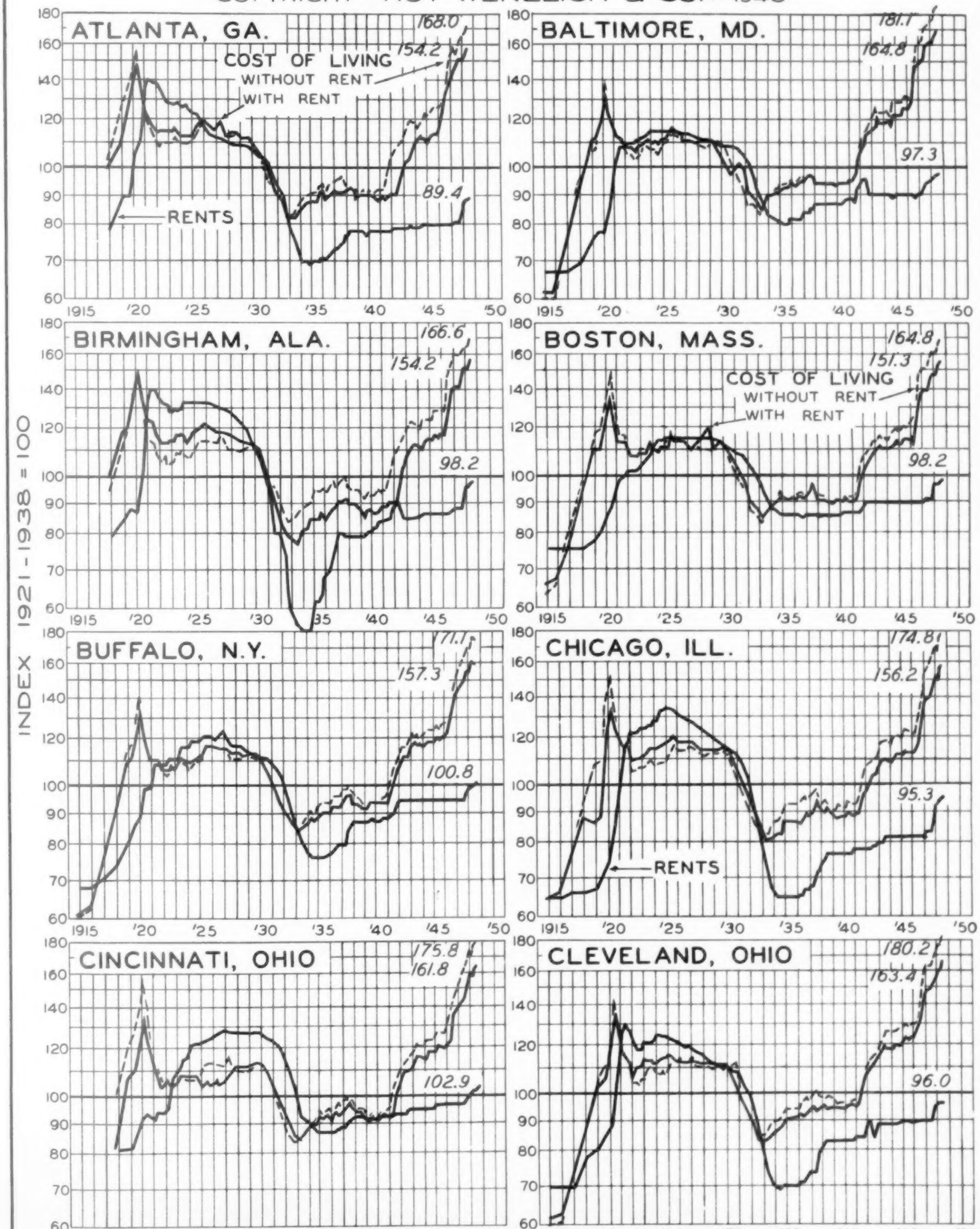
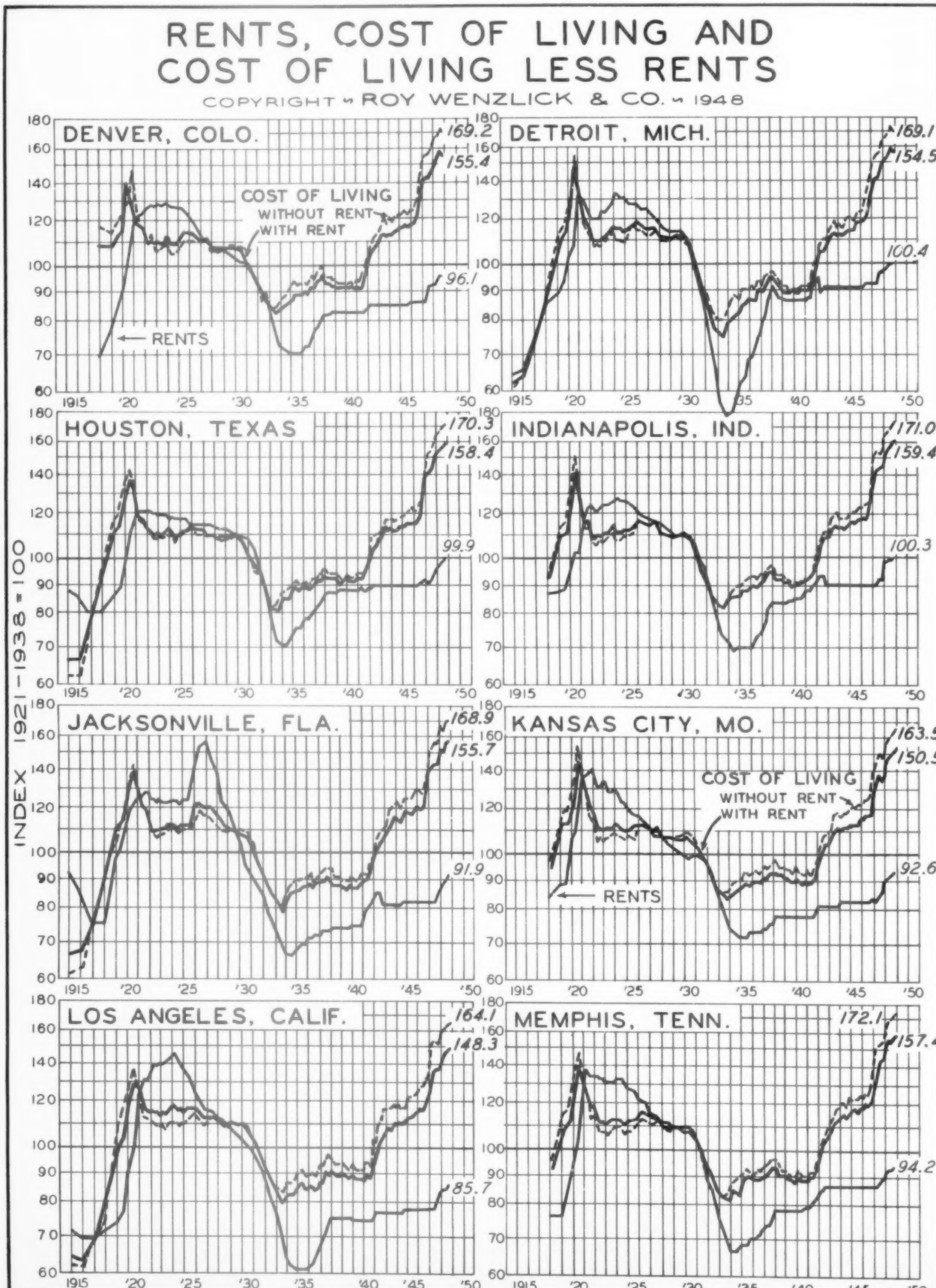
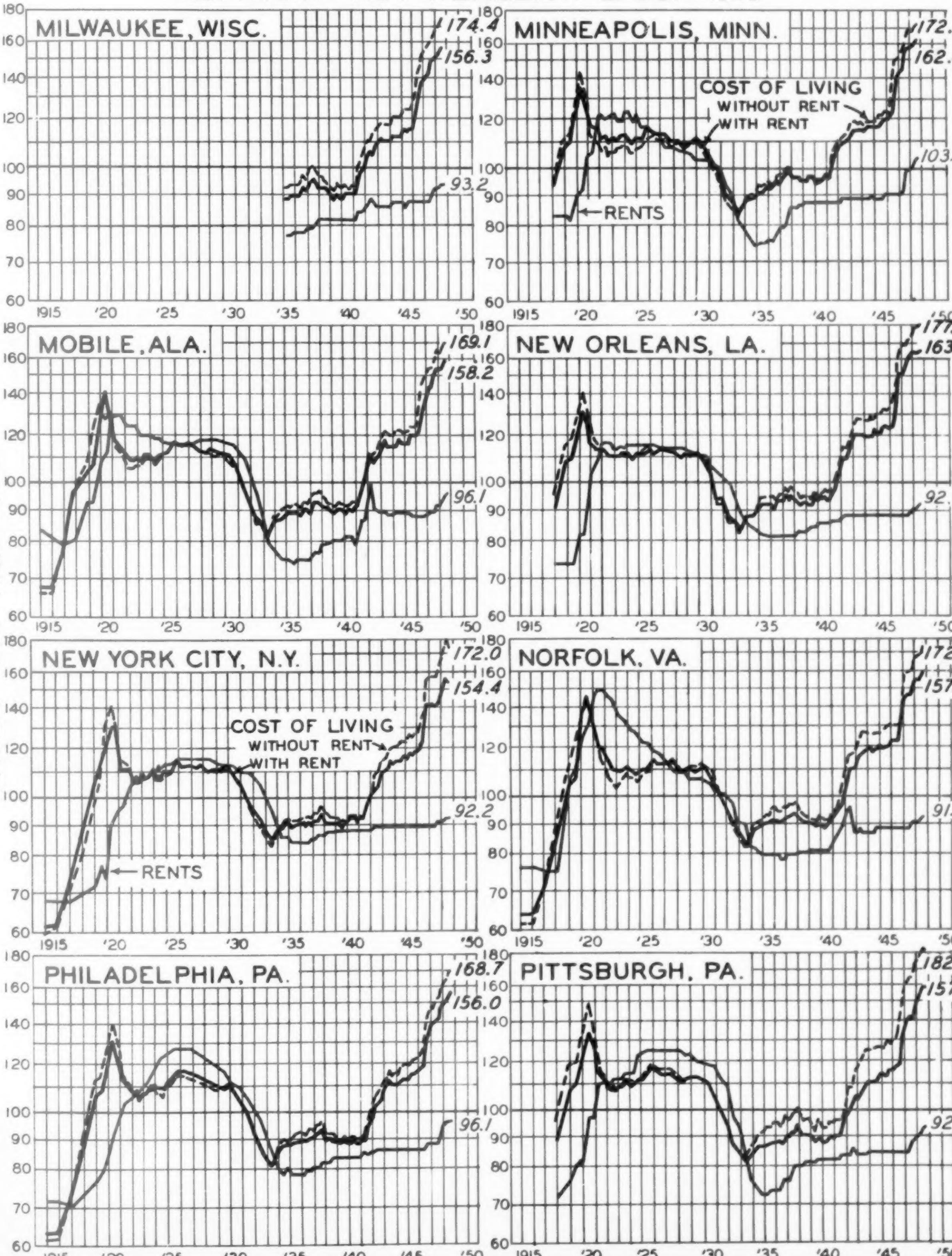



RENTS, COST OF LIVING AND
COST OF LIVING LESS RENTS
COPYRIGHT ROY WENZLICK & CO. 1948
INDEX 1921-1938 = 100
DENVER, COLO.
169.2
155.4
96.1
COST OF LIVING
WITHOUT RENT
WITH RENT
RENTS
DETROIT, MICH.
169.1
154.5
100.4
HOUSTON, TEXAS
170.3
158.4
99.9
INDIANAPOLIS, IND.
171.0
159.4
100.3
JACKSONVILLE, FLA.
168.9
155.7
91.9
KANSAS CITY, MO.
163.5
150.5
92.6
COST OF LIVING
WITHOUT RENT
WITH RENT
RENTS
LOS ANGELES, CALIF.
164.1
148.3
85.7
MEMPHIS, TENN.
172.1
157.4
94.2
1915 '20 '25 '30 '35 '40 '45 '50
60 70 80 90 100 120 140 160 180

RENTS, COST OF LIVING AND COST OF LIVING LESS RENTS



RENTS, COST OF LIVING AND COST OF LIVING LESS RENTS

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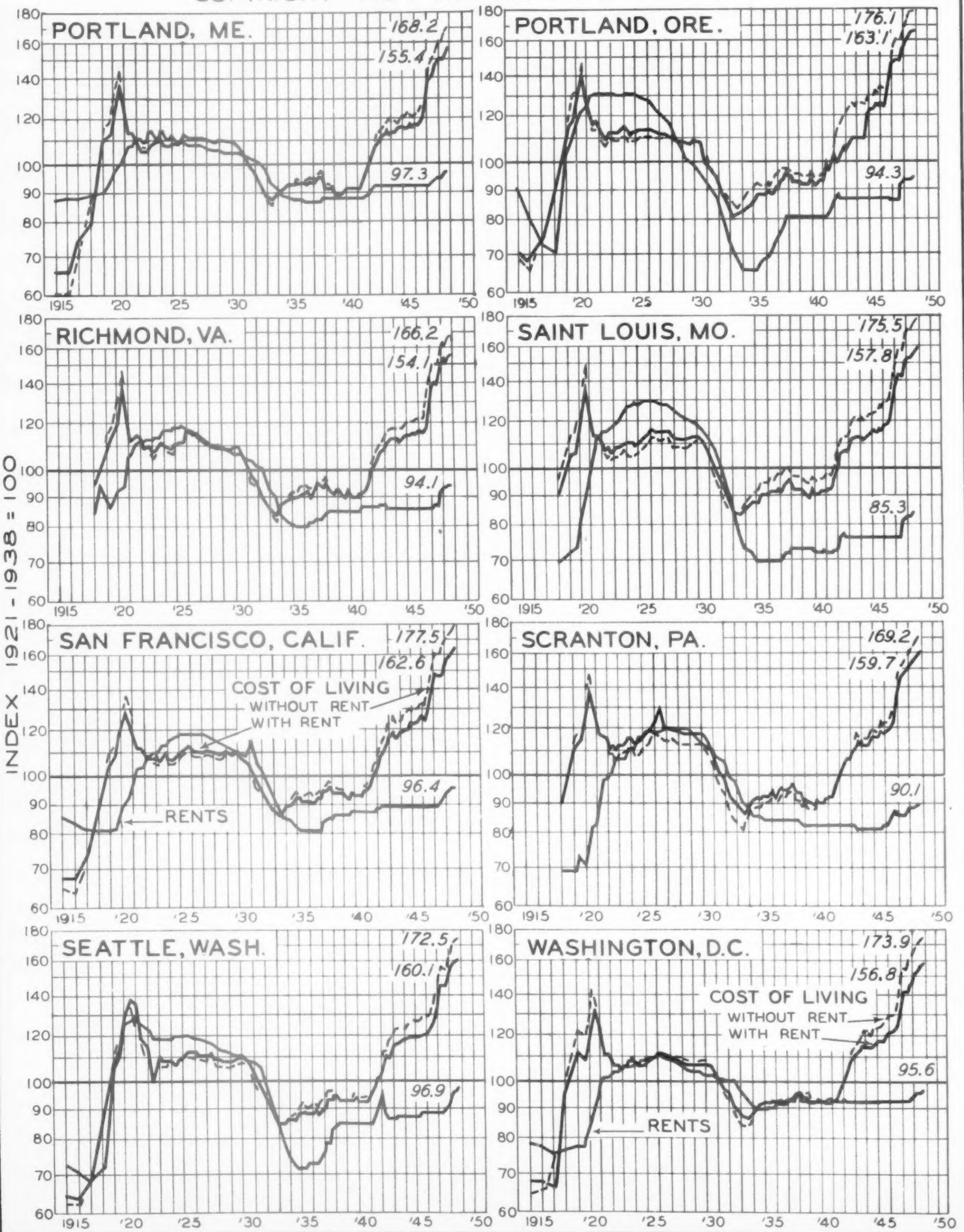
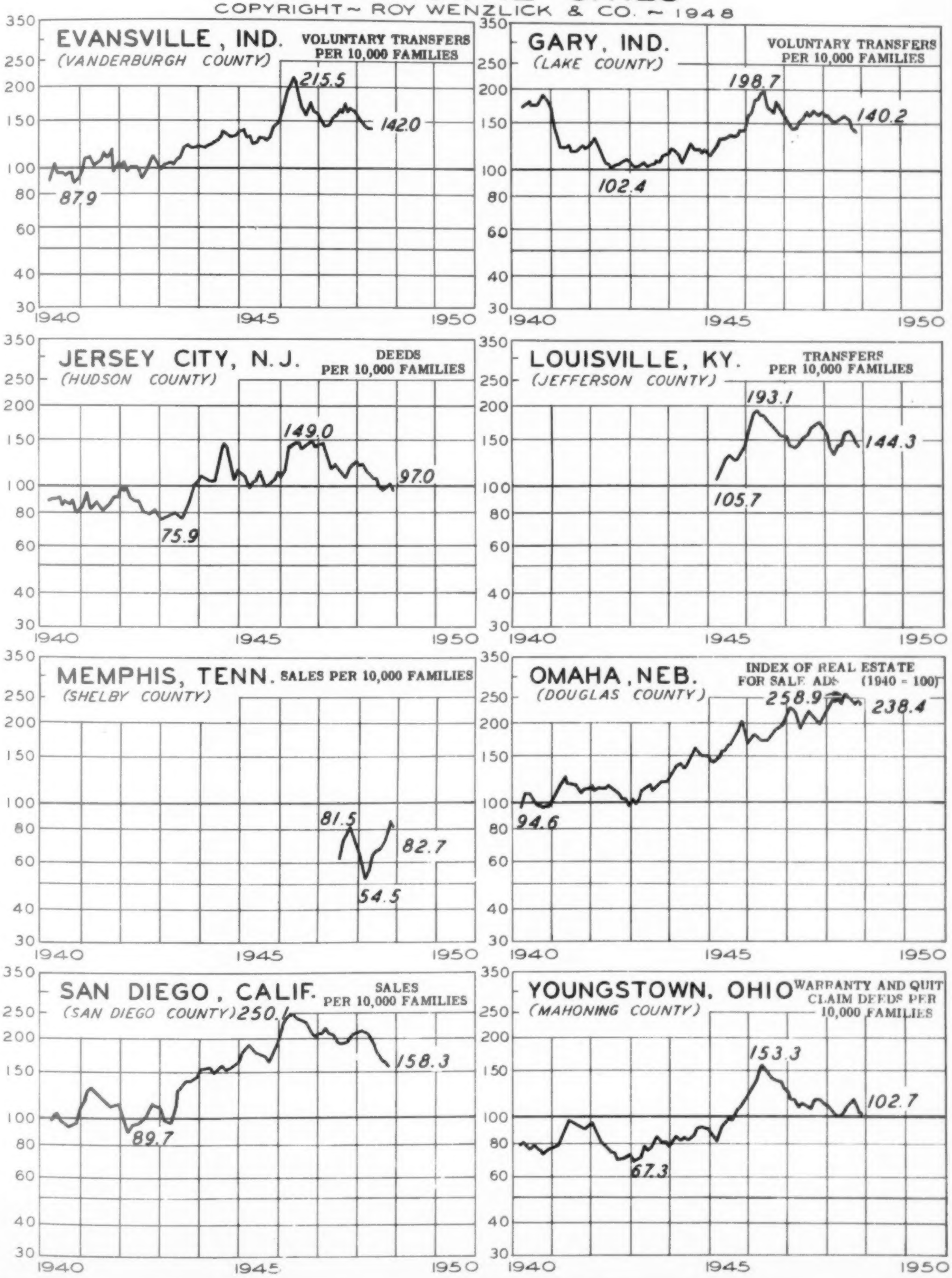
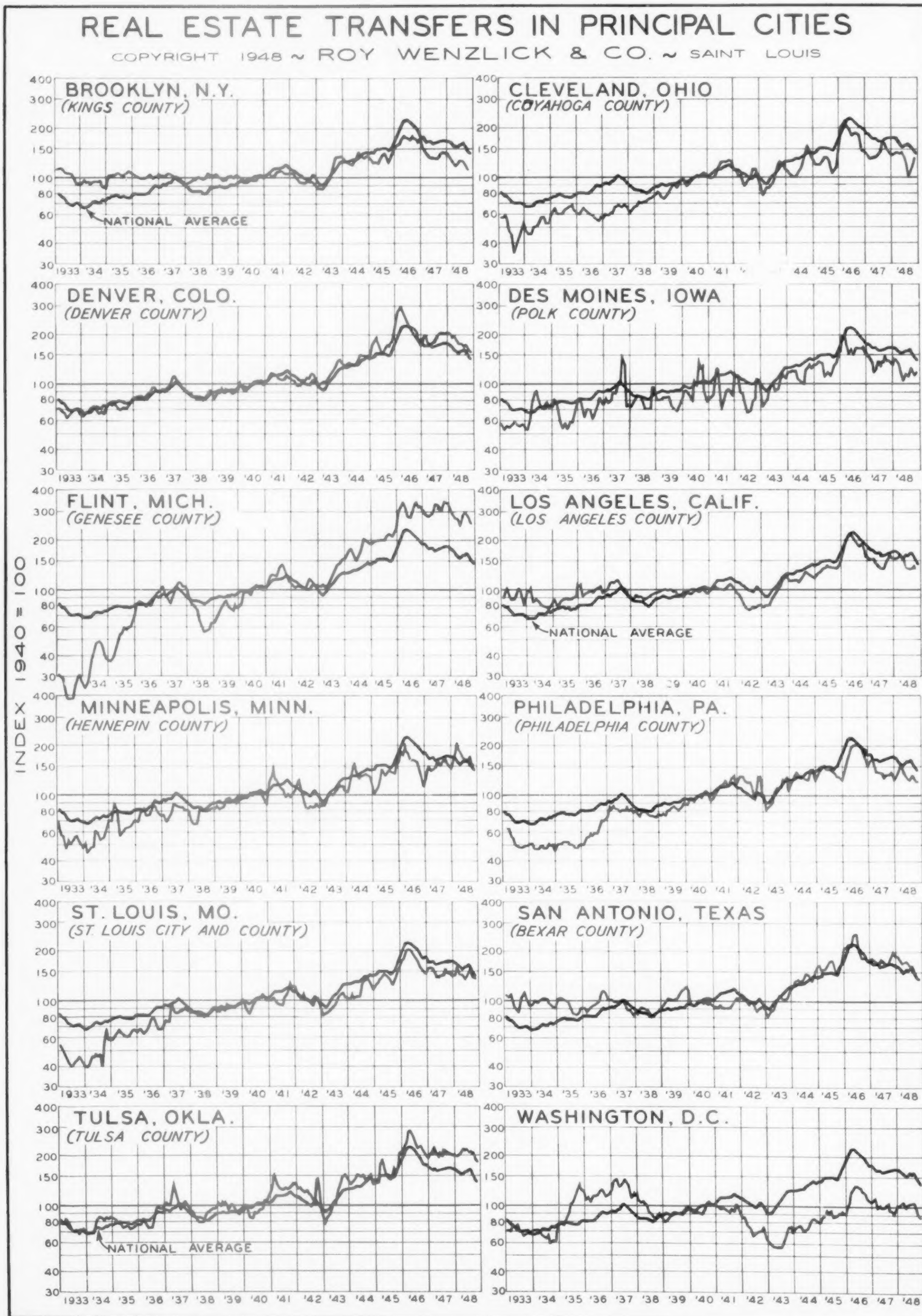


INDICATORS OF REAL ESTATE ACTIVITY IN PRINCIPAL CITIES




REAL ESTATE TRANSFERS IN PRINCIPAL CITIES
COPYRIGHT 1948 ~ ROY WENZLICK & CO. ~ SAINT LOUIS
INDEX 1940 = 100
BROOKLYN, N.Y.
(KINGS COUNTY)
NATIONAL AVERAGE
CLEVELAND, OHIO
(CUYAHOGA COUNTY)
DENVER, COLO.
(DENVER COUNTY)
DES MOINES, IOWA
(POLK COUNTY)
FLINT, MICH.
(GENESEE COUNTY)
LOS ANGELES, CALIF.
(LOS ANGELES COUNTY)
NATIONAL AVERAGE
MINNEAPOLIS, MINN.
(HENNEPIN COUNTY)
PHILADELPHIA, PA.
(PHILADELPHIA COUNTY)
ST. LOUIS, MO.
(ST. LOUIS CITY AND COUNTY)
SAN ANTONIO, TEXAS
(BEXAR COUNTY)
TULSA, OKLA.
(TULSA COUNTY)
NATIONAL AVERAGE
WASHINGTON, D.C.